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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 23

UNITED STATES OF AMERICA, PETITIONER

v.

DURHAM LUMBER COMPANY, a Corporation, and GEORGE H. CARTER, JR., formerly Trading as DIXIE CONCRETE AND SUPPLY COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENTS

QUESTION PRESENTED

Whether Federal Tax Lien enlarges the property rights or rights to property of a defaulting taxpayer, thereby extinguishing private rights and liabilities as between persons who do not claim by or through or in place of the defaulting taxpayer.

STATUTES INVOLVED

Statutes involved appear in the record at the following pages: 1-5, 16, 17.

SUMMARY OF ARGUMENT

A. Legal interests are created by state law. Section 6321 of the Internal Revenue Code of 1954 provides that, upon the failure of any person to pay any tax due to the United States, the amount thereof "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." It is therefore necessary that we refer to the property laws of the State of North Carolina for the purpose of determining the nature of the "property" and "rights to property" existing under the circumstances in this case.

B. Under the property laws of the State of North Carolina, the contractor (the defaulting taxpayer here) is required to furnish a list of his subcontractors and the amounts due each before he receives any payment, and it is the duty of the owner to withhold said amounts and pay them directly to the said subcontractors.

C. The subcontractors are given the opportunity to protect their right to payment (which right is superior to any the contractor may have) by giving notice to the owner.

D. The obligation of the owner to the subcontractor is primary, and his obligation to the contractor is secondary.

E. The subcontractors do not seek payment out of the property of the contractor (delinquent taxpayer); their claims are addressed to the owner.

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ARGUMENT

INTRODUCTION

This Court has held that, except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. This is true whether the law of the State is declared by the Legislature, by statute or by the highest court in a decision. *Erie R.R. v. Tompkins*, 304 U.S. 64.

The Court of Appeals in this case recognized the "priority of the Federal tax lien over a mechanic's lien when they attach to the same property" (R. 32) and correctly pointed out that here we have a "different situation" (*ibid*).

We shall show that the Court of Appeals properly applied the law of the United States and of the State of North Carolina to the facts as they appear in the record.

A FEDERAL TAX LIEN ON THE "PROPERTY" OR "RIGHTS TO PROPERTY" OF A CONTRACTOR DOES NOT EXTINGUISH PRIVATE RIGHTS AND LIABILITIES AS BETWEEN PERSONS WHO DO NOT CLAIM BY, THROUGH OR IN PLACE OF THE CONTRACTOR.

A. State law creates legal interests in property to which Federal tax liens may attach.

Section 6321 of the Internal Revenue Code of 1954 (R. 1) provides that, upon the failure of any person to pay any tax due to the United States, the amount thereof "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." It is clear under the decisions of this Court that the Internal Revenue Code does not create property interests or

rights to property, but that is a matter for State law. *Erie R.R. v. Tompkins* (*supra*); *Morgan v. Commissioners*, 309 U.S. 78; *United States v. Bess*, 357 U.S. 51. It is therefore necessary that we examine State law for the purpose of determining the nature of the property or interests in property under the circumstances here existing. *United States v. Bess* (*supra*); *U.S.F.&G. Co. v. Triborough Bridge Authority*, 297 N.Y. 31; *Fidelity & Deposit Co. v. New York City Housing Authority*, 241 F.2d 142, C.A. 2 (1957).

B. The contractor, before being entitled to receive any payment from the owner, must furnish the owner a statement.

Under the property laws of the State of North Carolina, a general contractor (here the defaulting taxpayer), before being entitled to receive any payment from the owner, is required to file with said owner a statement of all sums due subcontractors, and the owner is required to pay said sums directly to the subcontractors, N.C. G.S. §44-8 (R. 3); *Guilford Lumber Mfg. Co. v. Holladay*, 178 N.C. 417, 100 S.E. 597; *Perry v. Swanner*, 150 N.C. 141, 63 S.E. 611, and the failure to furnish such statement is a misdemeanor, N.C. G.S. §44-12 (R. 16).

C. Subcontractors may protect their right to payment by giving notice directly to the owner.

By statute, the subcontractors are given the opportunity to protect their right to payment by giving notice directly to the owner. When the subcontractor delivers the itemized statement to the owner "the claimant is entitled to all the liens and benefits conferred by law in as full a manner as though the statement were furnished by the contractor." N.C. G.S. §44-9 (R. 3).

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The appellees here gave notice to the owners (R. 5), and the owners were required to make payments to the subcontractors in preference to the contractor. *Hildebrand v. Vanderbilt*, 147 N.C. 639, 61 S.E. 620; *Charlotte Pipe & Foundry Co. v. Southern Aluminum Co.*, 172 N.C. 704, 90 S.E. 923; *Guilford Lumber Mfg. Co. v. Holladay* (*supra*); *Campbell v. Hall*, 187 N.C. 464, 121 S.E. 761; *Schnepp v. Richardson*, 222 N.C. 228, 22 S.E.2d 555.

D. The obligation of the owners to the subcontractors is the primary obligation.

Under the statutes and decisions of North Carolina, the subcontractor who notifies the owner of his claim has a lien superior to any lien the general contractor may obtain and an independent cause of action against the owner that he may maintain in his own name and right, without regard to time limitations, to enforce the lien. The owner may not avoid or reduce his liability to the subcontractors by any payment to the contractor. The obligation of the owner to the subcontractor is the primary obligation, and the obligation to the contractor is secondary. *Hildebrand v. Vanderbilt* (*supra*); *Charlotte Pipe & Foundry Co. v. Southern Aluminum Co.* (*supra*); *Guilford Lumber Mfg. Co. v. Holladay* (*supra*); *Campbell v. Hall* (*supra*); *Schnepp v. Richardson* (*supra*), N.C. G.S. 44-6 (R. 2) and 44-9 (R. 3).

E. The appellees do not seek payment from the delinquent taxpayer, but from the owner.

We should not ignore the fact that the tax lien reaches the property of the contractor, but not the property of the owners, and that here the subcontractors are asserting their independent rights against the owners and are not asserting any rights against the contractor. This case does not involve the priority

of liens but rather the more basic fact of whether or not the Federal Internal Revenue Code creates property rights, thereby obtaining an interest superior to that held by the contractor (the defaulting taxpayer).

This Court, when squarely presented this problem, has repeatedly held that this was not the result of the Federal Revenue Acts. *United States v. Bess* (*supra*); *Morgan v. Commissioners* (*supra*).

This case is not inconsistent with the cases of *United States v. Colotta*, 350 U.S. 808, summarily reversing 79 So.2d 474 (Miss.); *United States v. White Bear Brewing Co.*, 350 U.S. 1010, summarily reversing 227 F.2d 359 (C.A. 7th); *United States v. Vorreiter*, 355 U.S. 15, summarily reversing 134 Colo. 543, for the reason that these were cases involving priority of liens. The instant case does not involve priority of liens but involves whether or not the filing of a tax lien in favor of the United States imposes a lien on the property and rights to property of the defaulting taxpayer or whether, as is argued by the United States in this case, legal interests superior to the interests of the defaulting taxpayer shall be swept aside by the mere filing of the Federal tax lien, thereby in effect creating in the United States legal interests superior to those held by the defaulting taxpayer.

It is respectfully submitted that the tax liens on the property of the defaulting taxpayer do not and should not extinguish private rights and liabilities as between other persons who do not claim by or through or in place of the defaulting taxpayer.

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CONCLUSION

The decision of the District Court and the Court of Appeals for the Fourth Circuit is good law and should be affirmed.

Respectfully submitted,

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